

Surrebuttal Testimony of Dr. John Lacey

1 A. Yes. Based on the information received in other proceedings, I know that
2 AT&T's depreciation reserve percentage increased significantly from 1990 to
3 2000.

4 **III. CONCLUSION**

5
6 **Q. Please summarize your conclusions.**

7 A. The Department should adopt Verizon MA's proposed depreciation lives, which
8 are the same lives Verizon MA uses for its financial reporting and are based on
9 GAAP principles. AT&T/WorldCom's proposed lives, which are the lives the
10 FCC prescribed in 1996, are outdated by many years and do not reflect the current
11 and future state of competition in Massachusetts or the changing technological
12 environment. Mr. Lee's claim that Verizon's GAAP lives are biased because of
13 the accounting convention of conservatism and not appropriate for use in
14 regulation is incorrect and is in direct conflict with generally accepted accounting
15 principles (GAAP) and the modern practice of accounting. Verizon's
16 depreciation lives are in accordance with GAAP and, consequently, must be
17 unbiased.

18 The fact that Verizon MA's depreciation reserve has been increasing does
19 not provide empirical evidence that the 1996 FCC-prescribed lives are forward-
20 looking and appropriate for pricing UNEs. Mr. Lee's analysis is simply wrong
21 and is in direct conflict with basic depreciation concepts.

22

23 **Q. Does this conclude your surrebuttal testimony?**

24 A. Yes.

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E. 01-20 (Part A)

SURREBUTTAL TESTIMONY OF ALLEN E. SOVEREIGN

ON BEHALF OF VERIZON NEW ENGLAND INC.
d/b/a VERIZON MASSACHUSETTS

December 17, 2001

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1 **I. INTRODUCTION AND SUMMARY**
2

3 **Q. Mr. Sovereign, please state your name, address and present position.**

4 A. My name is Allen E. Sovereign. My business address is 600 Hidden Ridge, Irving,
5 Texas 75039. Verizon Services Corp. employs me as Group Manager-Capital
6 Recovery. I filed direct and rebuttal testimony on May 4, 2001, and July 18, 2001,
7 respectively.

8
9 **Q. What is the purpose of your surrebuttal testimony?**

10 A. The purpose of this surrebuttal testimony is to respond to the rebuttal testimonies
11 filed in this docket, by Warren R. Fischer, and Richard B. Lee. Warren R. Fischer
12 filed rebuttal testimony on behalf of the CLEC Coalition, and Richard B. Lee filed
13 direct and rebuttal testimony on behalf of AT&T and WorldCom.

14
15 **Q. What depreciation inputs are these parties recommending in this**
16 **proceeding?**

17 A. Mr. Lee and Mr. Fischer recommend the outdated projection lives and future net
18 salvage values last prescribed by the FCC in 1996 (based on information gathered
19 prior to 1995) for Verizon Massachusetts, Inc. ("Verizon MA"). Neither Mr. Lee
20 nor Mr. Fisher performed a depreciation study; they simply rely on an outdated
21 FCC prescription that was done in 1996, which was prior to passage of the
22 Telecommunications Act of 1996 (the "Act"). A prescription of lives set prior to
23 the Act could hardly contemplate all the subsequent changes in competition and

1 technology that have since occurred.

2

3 **Q. What are Verizon MA's proposed depreciation inputs?**

4 A. As Mr. Sovereign explained in his direct testimony, Verizon MA is proposing the
5 same depreciation inputs it uses for financial accounting purposes in 1999. These
6 lives were estimated using GAAP principles and were the most current lives
7 available when the UNE costs in this case were established. The financial
8 reporting parameters used for financial reporting in 2001 would be recommended
9 if the cost model were rerun today.

10

11 **Q. Please summarize your testimony.**

12 A. Verizon MA's proposed depreciation lives reflect the true economic lives of
13 Verizon MA's assets. Indeed, the evidence plainly demonstrates that Verizon
14 MA's proposed depreciation lives are proper for use in an economically
15 appropriate forward-looking cost study like the one filed by Verizon MA. On the
16 other hand, of course, they do not reflect the significantly shorter lives that would
17 be appropriate for use with the extreme instantaneous replacement assumptions
18 made in the AT&T/WorldCom cost model.

19 In addition, contrary to the contentions of Mr. Lee, Verizon MA lives are
20 not biased. Indeed, the FCC has recognized that the depreciation lives for many of
21 Verizon MA's assets have decreased since 1996. The FCC, for example, recently
22 approved at 10.5 year life for digital switching equipment in a proceeding involving

1 Verizon MA's affiliate in Virginia — Verizon South, f/k/a GTE South.^{1/}

2 Verizon MA is the only party in this proceeding that properly used
3 forward-looking depreciation lives that reflect the state of competition in
4 Massachusetts and the emergence of alternative technologies that shorten the lives
5 of Verizon MA's assets. Therefore, Verizon MA's proposed lives should be
6 adopted by the Department in this proceeding.

7
8 **II. AT&T AND WORLDCOM AND CLEC COALITION HAVE FAILED TO**
9 **DEMONSTRATE THAT VERIZON MA'S PROPOSED DEPRECIATION**
10 **LIVES ARE INAPPROPRIATE OR BIASED.**
11

12 **Q. What is the difference between "financial reporting" lives and "economic"**
13 **lives?**

14 A. There is no distinction between financial reporting, or GAAP, lives and economic
15 lives. It is Verizon's responsibility to select lives under GAAP that properly
16 allocate capital investment over their economic and/or useful lives.

17
18 **Q. Mr. Lee asserts that the financial reporting lives or economic lives should not**
19 **be used for regulatory purposes because they are influenced by the principle**
20 **of conservatism. [Lee Rebuttal at 4.] Does this principle influence your**
21 **determination of financial reporting lives?**

22 A. No. Verizon MA's proposed depreciation lives are Verizon MA's best estimate

^{1/} *In the Matter of The Revised Percentages of Depreciation pursuant to the Communications Act of 1934, as amended for: GTE North, Incorporated, and GTE South, Incorporated, FCC 99-369 (Nov. 23, 1999).*

1 and were determined in accordance with GAAP. The concept of conservatism and
2 other GAAP principles are addressed in greater detail in the surrebuttal testimony
3 of Dr. John Lacey filed on behalf of Verizon MA in this proceeding.
4

5 **Q. AT&T/WorldCom claim that Verizon MA's proposed lives are not reliable**
6 **and are biased. [Lee Rebuttal at 3-6.] Is their claim correct?**

7 A. No. Verizon MA's proposed 10 year projection life for digital switching
8 equipment is not biased. The FCC, in fact, recently adopted a 10.5 year digital
9 switch life for Verizon MA's sister company, Verizon South Inc. The FCC,
10 therefore, has already recognized that changing technology and the competitive
11 market have dramatically shortened lives for digital switching.
12

13 **Q. Please respond to Mr. Fisher's claim that the lives accepted by the**
14 **Department were not for regulatory purposes, but for accounting purposes.**
15 **[Fisher Rebuttal at 7.]**

16 A. As previously discussed, Verizon's recommended depreciation lives comply with
17 the Department's directive that depreciation lives must not exceed the lives
18 prescribed by the FCC in its most recent prescription. The fact that the
19 Department allowed the use of financial reporting lives and Verizon has been
20 charging depreciation expense based upon those lives make them more appropriate
21 than the FCC prescribed lives, because they represent the actual forward looking
22 life that Verizon MA is currently using to book expense.
23

1 **Q. How do the present and future state of competition in Massachusetts impact**
2 **the depreciation life for digital switching equipment?**

3 A. Competition in telecommunications markets has resulted in many competitors
4 placing their own switches. As these competitors attempt to differentiate
5 themselves with new products and/or enhanced offerings, the switch vendors are
6 responding with new and different switch platform/components. In order to meet
7 this fierce competition Verizon's switches must "keep up" with the competition.

8 Some competitors, for example, are beginning to develop packet switching
9 capabilities and Internet telephony capabilities. As packet switching technology is
10 further refined and becomes even more affordable, data switches and voice-over-IP
11 telephony will pose a formidable competitive challenge to Verizon MA's circuit-
12 switched networks.

13 In a competitive world, a company that does not rationally deploy new
14 technology will fail. Customers will look to competitors to provide the services
15 they desire.

16

17 **Q. Do you believe that DSL technology extends the life of copper, as Mr. Lee**
18 **claims? [Lee Rebuttal at 15.]**

19 A. No. Mr. Lee's conclusion that DSL will increase the life of copper cables in the
20 future is baseless. Although DSL technology has allowed Verizon to use some of
21 its existing copper to meet current bandwidth requirements, further increased
22 bandwidth requirements, packet switching technology and other technologies will
23 continue to require that fiber be placed closer and closer to the customer

1 Indeed, if copper were truly the best alternative for new plant, the
2 competitors would be placing copper, rather than coaxial, fiber and wireless. As
3 stated above, DSL allows the ILEC to get the maximum use from the existing
4 copper, allowing time to for broadband networks to be put in place.

5
6 **III. VERIZON MA'S PROPOSED DEPRECIATION LIVES ARE**
7 **CONSISTENT WITH THE LIVES REPORTED BY VERIZON'S**
8 **COMPETITORS.**
9

10 **Q. Mr. Lee asserts that competitor lives do not provide an appropriate**
11 **benchmark for lives to be used in TELRIC calculations. [Lee Rebuttal at 6.]**
12 **Do you agree?**

13 A. No. The depreciation lives reported by Verizon's competitors certainly provide a
14 benchmark to test the reasonableness of Verizon's estimates. In fact, because the
15 Department is determining forward-looking depreciation lives, these benchmarks
16 should provide the *ceiling* for depreciation lives. Depreciation lives would be
17 much lower if AT&T/WorldCom's instantaneous network assumptions were
18 adopted (which they should not be).

19 The depreciation lives adopted by the Department in this proceeding should
20 be no *higher* than lives reported by Verizon MA's competitors.

21
22 **Q. Do you agree with Mr. Lee that the lives of direct competitors such as**
23 **AT&T, WorldCom, and CATV providers are not comparable to, or relevant**
24 **to the lives used by Verizon?**

1 A. No. Depreciation lives estimated in accordance with GAAP are unbiased, and
2 comparable. As Mr. Sovereign explained in his direct testimony, AT&T's financial
3 reports reveal that AT&T's financial reporting lives are *shorter* than the lives
4 proposed by Verizon MA in this proceeding.

5
6 **Q. Do you agree with Mr. Lee that the lives adopted by the FCC for CATV**
7 **operators are not comparable to the lives recommended by Verizon for**
8 **TELRIC calculations? [Lee Rebuttal at 7.]**

9 A. No. As Mr. Lee pointed out, the FCC adopted life ranges for CATV operators
10 that were based on financial book lives, essentially GAAP lives. Mr. Lee's attempt
11 to distinguish the FCC's adoption of GAAP lives for CATV operators is
12 unpersuasive. CATV companies provide a good benchmark because companies
13 such as AT&T also provide telephone service over their plant in some locations.
14 These networks consist of cable and electronics which supply data and voice
15 communications, just as does Verizon's network. Cable modems, for example,
16 directly compete with DSL service.

17 Significantly, in analyzing the CATV GAAP lives, the FCC observed that
18 there was no evidence that the CATV operators' lives were suspect or biased.^{2/}
19 Likewise, AT&T/WorldCom have presented no evidence in this proceeding to

^{2/} Order, *In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service*, MM Docket No. 93-215 and CS Docket No. 94-28, Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking, FCC 95-502, 11 FCC Rcd. 2220, at 2258, 2314 ¶ 82 (Jan. 26, 1996).

1 demonstrate that Verizon's proposed lives are biased or unreliable. In fact,
2 Verizon MA's financial reporting lives have been steady and consistent since
3 regulatory lives were abandoned.

4 Notably, the lives used by CATV operators are *shorter* than Verizon MA's
5 recommended lives.^{3/}

6 In short, the lives selected by many CATV operators can be used for
7 comparative purposes and provide the ideal benchmark against a major competitor
8 for the forward-looking TELRIC depreciation study inputs for this docket.

9
10 **Q. Do you agree with Mr. Lee's criticisms [Lee Rebuttal 7-11] of Technology**
11 **Futures Inc. ("TFI")?**

12 A. No. Verizon used TFI lives as a benchmark comparison, just like it used
13 competitor financial reporting lives as a benchmark. TFI is an independent
14 research firm that specializes in technology forecasting, and has released numerous
15 studies forecasting the evolution of the telecommunications network.
16 Benchmarking against industry studies and competitors' lives provides an excellent
17 check on the reasonableness of Verizon's recommendations.

18 Importantly, Verizon MA is not proposing in this proceeding the lives
19 recommended by TFI; therefore, Mr. Lee's extensive criticism of the TFI lives is a red
20 herring.

21
22 **Q. Do you agree with Mr. Lee that the 20 jurisdictions referenced in the**

1 **testimony of Mr. Lee [Lee Rebuttal at 8, and Lee Direct at 10-13], adopted**
2 **the FCC prescribed projection lives?**

3 A. No. Mr. Lee's reference is misleading. The full context of Mr. Lee's statement is
4 "[i]n most states where orders have been issued, lives prescribed by the FCC, or
5 similar state prescribed lives, have been adopted." [Lee Rebuttal at 8.] While
6 some of the adopted lives were FCC prescribed lives, some were also at the
7 bottom of the FCC range and some were lives prescribed or accepted by state
8 commissions at levels below the FCC ranges.

9
10 **IV. AT&T AND WORLDCOM MAY NOT MIX AND MATCH**
11 **DEPRECIATION LIVES AND FUTURE NET SALVAGE VALUES.**

12 **Q. Does Mr. Lee approve of Verizon MA's proposed future net salvage**
13 **percents? [Lee Rebuttal at 2.]**

14 A. Yes. Mr. Lee stated that he does not oppose the use of the future net salvage
15 percents recommended by Verizon.

16
17 **Q. Are projection lives and future net salvages values independent of one**
18 **another?**

19 A. No. There is a dependent relationship between these two inputs. For example, if
20 you purchase an automobile and intend to use it for 5 years, the salvage value for
21 that automobile will be much higher than the salvage value for an automobile you
22 intend to use for 10 years. In the first instance, you might expect a salvage value

^{3/} *Id.*, ¶ 91.

1 of 20%, whereas in the second instance only junk salvage of 1 or 2 % may be all
2 that can be expected. By mixing projection lives and net salvage values based on
3 inconsistent assumptions, Mr. Lee is merely trying any combination he can come
4 up with to support artificially low UNE prices.

5
6 **V. CONCLUSION**

7 **Q. Please summarize your conclusions regarding the rebuttal of Verizon MA's**
8 **proposed depreciation lives submitted by Mr. Lee, and Mr. Fisher.**

9 A. Mr. Lee has failed to demonstrate that the FCC's 1996 regulatory prescribed lives
10 should be used in 2001 in place of the lives that Verizon MA uses for financial
11 accounting purposes. The lives proposed by Verizon MA are supported by
12 evidence of what is really happening in the telecommunication industry in 2001.
13 Moreover, as Mr. Sovereign explained in his direct and rebuttal testimony, Mr.
14 Lee's proposals do not account for the significant pace of competition and
15 technological innovation that has taken place since 1996 and is expected to
16 continue in the future. Mr. Fisher likewise fails to support his proposals. He does
17 no study of his own, but instead relies on the misleading information supplied by
18 Mr. Lee.

19 Verizon MA's recommended depreciation lives best comply with forward-
20 looking costing principles by using depreciation lives that reflect the current and
21 future telecommunications environment in Massachusetts.

22
23 **Q. Does this conclude your surrebuttal testimony?**

1 A. Yes.

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